

## Unclaimed Property Task Force

Thursday, October 2, 2014

1:30p.m. – 3:30p.m.

Buck Library, Buena Vista, New Castle, DE

### Meeting Attendance

#### Task Force Members:

##### Present:

Senator Bryan Townsend  
 Representative Bryon Short  
 Senator Greg Lavelle  
 Representative Jeff Spiegelman  
 Secretary Jeffrey Bullock  
 Secretary Thomas Cook  
 Thomas Collins  
 Michael Houghton  
 Edward Ratledge  
 Jordon Rosen  
 Stan Stevenson  
 Leonard Togman  
 Robert Tuinstra, Jr.  
 Michael Barlow

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##### Absent:

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##### Attendees:

Jamie Johnstone  
 David Gregor  
 Courtney Stewart  
 Caroline Cross  
 Rebecca Byrd  
 Ferdinand Hogroian  
 Rick Gisenberger  
 Deb Zumoff  
 Freda Pepper  
 Alison Iavana  
 Michelle Whitaker  
 James Dechene  
 Alton Irvin

##### Organization:

DOF  
 DOF  
 CGO  
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 Byrd Group, LLC.  
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The Task Force Meeting was brought to order at 1:45 p.m.

### **CONSIDERATION OF MEETING MINUTES, SEPTEMBER 10, 2014**

Senator Bryan Townsend, co-chair, thanked the members of the Task Force and the public for attending the meeting. He addressed the first item on the agenda: consideration of the previous meeting's minutes. He apologized that the minutes from the previous meeting were only distributed with one day's notice. In order to give the members of the Task Force time to review the minutes, the minutes will be approved at the next meeting.

### **PRESENTATION BY DEPARTMENT OF FINANCE (DOF)**

Secretary Thomas Cook, DOF, said that DOF would like to use this opportunity to answer some questions that Task Force members had asked in earlier meetings. There had been a lot of discussion in the previous meeting about the exact meaning of the 8% figure that Kelmar had mentioned in their presentation. Approximately 24% of total revenue from Delaware's abandoned property program is generated from the general ledger audits. Approximately 40% of that 24% is generated through estimation in those general ledger audits. The amount of estimation as a percentage of the total (24% x 40%) is 9.8%, which is approximately the figure that Kelmar gave.

Michael Houghton, Uniform Law Commission, asked if that would mean that, for example, if the total amount of revenue derived annually from unclaimed property in its aggregate was \$500 million, that approximately 24% of that (\$125 million) would be general ledger audit and only 10% (\$12.5 million) of that is the consequence of estimation.

Secretary Cook said that the chart in his presentation used FY 2008 – FY 2013 as base years.

Mr. Houghton asked if that meant that a lot of what the Task Force was talking about, including the look-back period and reasonableness of estimation, in his hypothetical was a \$12.5 million argument.

Senator Townsend requested that someone check the math on the figures presented in the chart, since he believed they were incorrect.

Mr. Houghton asked if the 10% was 10% of the total amount or of the 24% related to general ledger audits.

Senator Townsend said 40% of the 24% was a result of estimation, or approximately 10%.

Jordon Rosen, Delaware State Chamber of Commerce (DSCC), said that there were amounts being given in percentages and dollar amounts. He was not sure if these referred to the number of audits or dollars generated by the audits. Those are two very different things. He asked if the percentages referred to dollars or the number of audits.

Mr. Houghton said that it was the total amount of revenue generated by audits in the general ledger. There are of course audits that relate to other sources, such as equities and dividends.

Secretary Cook said that in securities there is no estimation.

Mr. Houghton said that the total amount of revenue generated as a result of audits is more than 24% of the total because a not insignificant portion of that was the function of audits related to equities.

Deputy Secretary David Gregor, DOF, said that the chart only refers to general ledger audits.

Senator Townsend asked for clarification that of all the money related to Delaware's unclaimed property program, 24% is from general ledger audits.

Deputy Secretary Gregor said that was correct.

Mr. Rosen asked that if there were dollars instead of percentages (and if the total was \$500 million) that the 9.8% would be roughly \$50 million and the 24% would be \$125 million.

Deputy Secretary Gregor said that was correct.

Senator Townsend asked if, using the \$500 million example, approximately \$50 million would relate to estimation.

Deputy Secretary Gregor said that was correct.

Mr. Togman stated that these numbers are not an average, but rather an annual total.

Senator Townsend said that was a good point. He asked if those numbers were relatively consistent over the years or if estimation has been increasing or decreasing.

Deputy Secretary Gregor said the dollar amounts change a lot from year to year but that estimation has been pretty consistent.

Senator Townsend said there are two layers to this discussion, one being the percentage of all revenues related to general ledger audits and the second being in general ledger audits what percentage is related to estimation versus non-estimation. He asked if the 10% is consistent over the years.

Deputy Secretary Gregor said the 40% is consistent. There could be years for which the general ledger percentage was 15% and others for which it was 50%. On average, over the six-year period, it was 24%.

Senator Townsend asked if there were any trends in this data.

Mr. Rosen asked what percentage did general ledger audits constitute in 2012 and 2013.

Deputy Secretary Gregor said in 2013 it was approximately 35% of revenue.

Mr. Rosen noted that would mean that estimation in 2013 would have been closer to 15%.

Mr. Togman asked if the Task Force could be provided with the totals broken down by years.

Deputy Secretary Gregor said that the Task Force should have already received that information. The 24% figure will change from year to year depending on how many audits are conducted. The percent of general ledger examination from estimation (40%) is relatively constant.

Senator Townsend said that there is nothing wrong with averaging, but he wanted to know if there were any trends in the data that were disguised by averaging.

Deputy Secretary Gregor said he did not think there were any identifiable trends.

Robert Tuinstra, Jr., Delaware Business Roundtable (DBR), asked how much money was coming from estimation in general ledger audits. Is that the 40% and is that stable?

Deputy Secretary Gregor said that Mr. Tuinstra, Jr. was correct and that it was stable. Equity examinations would be set aside and put in a different category.

Mr. Tuinstra, Jr. asked if the equity examinations use estimation.

Deputy Secretary Gregor said they do not.

Secretary Jeffrey Bullock, Department of State (DOS), said that the holders he works with in the VDA program welcome estimation because it saves them money.

Mr. Togman said that there are many holders who do not feel that way.

Mr. Houghton said that the people that Secretary Bullock works with in the VDA program are in a managed process where the benefit of many presumptions are taken by them in their favor in the course of quantifying liability. It does not mean that it is not a credible program, but it does mean that by its design that it is intended to be collaborative and cooperative. He said the consequence of extrapolation and estimation in the VDA context is not as severe as it would be if the company was not in the VDA. It is fundamentally different in its result. If it was not, 713 companies would not have joined the VDA program. Mr. Houghton believes that many companies would not view estimation favorably if \$40 million - \$100 million are the result of estimation in a year derived from general ledger audit. Holders may view estimation differently depending on whether they are in the VDA program or not.

Secretary Bullock said that how estimation is viewed is in the eye of the beholder. It has less to do with estimation and more about the audit process.

Mr. Houghton said that it has everything to do with the result of estimation. He would contend that holders that go through the VDA program, even in a situation where estimation is used, pay significantly less to the State of Delaware than they would if they had gone through the audit program. There are many people in the holder community who say that is the way it should be; the Secretary of State's VDA program, even with estimation, is a more realistic assessment of what the liability is. Mr. Houghton thinks is more about the result than the methodology. If someone goes through the VDA program and pays \$1 million but if they went through an audit they would pay \$11 million, then estimation is really irrelevant if the consequence is that they are paying \$10 million less.

Secretary Bullock agreed that it was less about the methodology and more about the result.

Secretary Cook said he wanted to clarify that the holders are part of the discussion when the base years for extrapolation are being selected. At the last Task Force meeting, there was some concern about the methodology that audit companies were using. Mr. Ratledge met with auditors that work for Kelmar and can report to the Task Force about his findings.

Edward Ratledge, public member, Director of the Center for Applied Demography & Survey Research (CADSR) at the University of Delaware, said when he met with Kelmar he asked to be walked through the audit process, such as the sampling procedures and how the final estimate was calculated. Some of the data showed remarkable changes from one period to the next. New accounting systems after Y2K showed an increase from few reports of abandoned property to large amounts of abandoned property. The conclusion he reached from that trend is that companies were significantly underreporting or did not know, and that it is difficult to tell which.

Mr. Ratledge said there are many instances where the holder gets to negotiate with Kelmar auditors on the measures that are being used. Sometimes they make the wrong choices for their company, but they are still given that opportunity. There were opportunities to challenge items that had been found within their records and have those eliminated from the calculations. There is a final stage where the stratified sample is taken from the total number of items and research is done on those items. Even after that, the holder has an opportunity to negotiate whether the items should be included. The final step is when the auditors do the look-back on a particular section, like annual revenues in the past twenty years, and examine the relationship between the periods for which there is no data and the periods for which there is good data. The measure in that case is also negotiable.

Mr. Ratledge said that he could see nothing wrong with Kelmar's methodology. The data is largely based on data after Y2K, so the measures are very good. The results between the Secretary of State's VDA program and the DOF audit program will be different, particularly since the look-back in the VDA program is limited to 1996. The intensity is different. Mr. Ratledge said that when he spoke with Kelmar's statistician and one of their auditors he agreed with the way they performed the audit.

Michelle Whitaker, DOF, said that she agreed with Secretary Bullock that there are holders that recognize that they have an obligation to file and are compliant with the process. The majority do not. Some holders have thanked Ms. Whitaker and her team after an audit. She said this indicates that there is a level of professionalism shown by DOF and auditors. Ms. Whitaker said she is willing to negotiate with holders if there is a measure they do not agree with. She does not think that all holders are necessarily trying to get out of their obligations.

Secretary Cook returned to his presentation. He said that in the previous fiscal years, DOF has returned \$15 million - \$20 million to owners. In FY 2014, that amount significantly increased to \$104 million paid (\$46 million in cash and \$58 million in pre-liquidated shares). This is because DOF has been focusing on improving their due diligence and sending out more letters to claimants notifying them of their property.

Senator Townsend asked why there was a change in policy in not liquidating the shares.

Secretary Cook said DOF found that assets were being turned over to them without proper due diligence being done by the holders. The goal of the program is to return property to the rightful

owner. By engaging in more due diligence, the State is able to accomplish that goal more often. This is an ongoing policy. Previously, DOF used to liquidate shares thirty days after they were turned over to the State. There was an assumption that the holders had already done the due diligence. When it was found that was not the case, DOF increased its due diligence.

Senator Greg Lavelle said there was a tremendous difference between the amount of claims paid in FY 2014 and in the FY preceding that. It seems like the consumer got the short end of the stick for quite a while. He asked why companies were just turning over their unclaimed property to the State without performing due diligence.

Secretary Cook said that answer relates to the U.S. Supreme Court's (SCOTUS) decision that the property does not belong to the holder. It does not matter to the company which state gets the property since they know they are not allowed to keep it. It is easier for holders to send the property to the State and have the State do the work of doing due diligence.

Senator Lavelle said that either people who were supposed to get property in FY 2013 and before did not, or people who were not supposed to get it did in FY 2014.

Secretary Cook said one thing to keep in mind is that the State will return the property if the claimant has the proper documentation, whether that is after two years or 25 years.

Senator Townsend asked how much revenue came in after the recent developments relating to transfer agents. Could some of the numbers in the chart be elevated because of that?

Secretary Cook said that it was \$195 million and agreed that some of the numbers could be elevated for that reason.

Deputy Secretary Gregor said that it looks like the rate of cash returned will be approximately the same rate this year.

Secretary Cook said that it is important to keep in mind that it is the responsibility of the holder to turn over unclaimed property to the State. The State made the assumption that the holder has done due diligence and made attempts to reach out to the owner.

Deputy Secretary Gregor said that if DOF had not had someone look at the transfer agency books and records, this lack of due diligence on the part of the holder would not have been discovered. Through the course of that investigation, hundreds of millions of dollars were switched from inactive status to active status.

Stan Stevenson, Delaware State Bar Association (DSBA), asked if the spike in cash is all related to the dividend property type that came in as a result of the examination of the transfer agency.

Deputy Secretary Gregor said that may have contributed some, but he thinks the spike in cash is more likely due to DOF using better methodology and processing methods.

Mr. Houghton asked if the \$46 million in cash was going to Delaware residents.

Deputy Secretary Gregor said no, about half of that amount was going to foreign (non-U.S.) addresses.

Mr. Houghton asked if the remaining half was going to Delaware residents.

Deputy Secretary Gregor said some part of that would, but he was not sure what the exact number was. If the State receives unclaimed property and the last known address is in Alaska, they send it there.

Mr. Houghton said he understood that, but he wanted to point out that although it is great that DOF is increasing its consumer protection, but he did not want the Task Force to think that means \$104 million is being returned to Delaware citizens. The overwhelming amount of that is not. He questions why the State is receiving money that has addresses in other states or in other countries since the laws of escheat provide that it be returned to the state of the last known address. The State might say that at the time it is remitted to them there was no address associated with the property. Subsequent research allows the State to investigate where the property should be sent. Mr. Houghton advises his clients against sending money to a state if there is an address which sources the money somewhere else. He guesses that Delawareans are receiving less than 10% of the \$104 million paid in claims in FY 2014.

Deputy Secretary Gregor said that the money goes to the last known address of the holder. If a college student at the University of Delaware has an account and then ends up working in Wisconsin, the last known address is in Delaware. If someone notifies the student that they have this property and they file a claim, the State of Delaware would end up sending that money to Wisconsin because that is the address of the rightful owner.

Senator Townsend asked what the process is for returning property if the owner is found to live in another state. He asked if the check is simply sent to the last known address and the State waits to see if it is deposited or returned.

Deputy Secretary Gregor said no. The owner has to file a claim and establish that they are the rightful owner.

Senator Townsend said that he received Facebook messages from a woman in California who was very frustrated with the amount of time it was taking her to get the proceeds from a stock sale. It was very clear that once the stock had been sold, the proceeds should have been remitted very quickly- not after a lengthy waiting period and not a check by U.S. mail. Legislators do hear from constituents who are concerned about this process. It is good to know that there is a focus on improving the customer service aspect of this process.

Senator Lavelle said that there seems to have been a change in methodology between FY 2013 and FY 2014 that improved returns. He said that this is proof that processes can change to be more fair and equitable for everyone. He thinks that these processes need to be looked at from time to time to make sure that the State is not the only one benefitting from them.

Secretary Bullock said that estimation can work very well in some contexts and not in others. It is important to be very careful with estimation. Secretary Bullock said that he agreed with Senator Lavelle that changing this process was a reaction on the part of DOF to criticisms. That is excellent.

Senator Lavelle suggested that this idea of reacting to criticism to improve systems and services is one that could be applied to this Task Force.

Tom Collins, Delaware Bankers Association (DBA), asked if the change in DOF's policy regarding processing and distributing shares is a change they will maintain in the future.

Secretary Cook said that they would.

Mr. Collins asked if the State was going to become the registered holder of those shares.

Secretary Cook said that in the past when the State received escheated shares they used to be liquidated within thirty days. If an owner was identified after the shares were liquidated they were given the funds that were received from the sale of the shares. The concern was that not all holders were performing due diligence to find owners. Now when the shares are escheated to the State, the State sends out two letters to try to find the most updated address (sometimes using tax records) of the owner. If the owner does not contact the State to claim the property within 60 – 90 days, then the shares are liquidated. If the owner is identified after that time and they want the shares back instead of the liquidated cash, the State would have to buy back the shares for them.

Mr. Togman asked what would happen if the shares were in a brokerage account.

Secretary Cook said that DOF attempts to contact the owner through the last known address. They also look at tax records.

Mr. Togman asked if the shares were in a Merrill Lynch brokerage account if the shares would go back to them and they would be responsible for finding the owners.

Deputy Secretary Gregor said he was not sure about the specifics of that particular situation, but he could find out that information.

Senator Townsend asked what kind of standard is there or should there be with regards to holding shares. He asked if there is any kind of fiduciary standard. It is likely that there have been people who were upset that the shares were liquidated. He asked if other states have different procedures.

Deputy Secretary Gregor said that after due diligence it is standard practice to sell the shares immediately so there are no accusations that the State is trying to influence the stock market.

Mr. Houghton said other states, particularly California, have been sued for taking shares into escheat, disposing of them in the marketplace, and then the owner of the shares claiming that due diligence was not done. He thinks that this is a topic of general discussion around the country. Corporate America is looking for clarity in the rules of remitting and tendering shares to the State as well as the time period for selling them. Delaware has been responsive in this particular interest to the concerns of the equity community. There is no longer the thirty-day liquidation of shares. This influx is a result of a change in the law. The spike in the equity issue and the amount of money being remitted is a function of an enforcement mechanism put in place by the State in the last 2 – 3 years on equity that is now going to trail off. Mr. Houghton does not think this spike will be seen again. He believes the equity revenue is going to level off and become a more a more consistent level than it has been.

Senator Townsend asked if it was going to be at a higher level than it was previously.

Mr. Houghton said he is not sure if it will be significantly higher. It was a backlog of reporting that had not been done for 20 – 30 years, and now many people are not in compliance historically but will be in the future. It is probably going to be slightly higher in equities.

Deputy Secretary Gregor said that it might be slightly higher but it depends on a lot of factors.

Mr. Houghton said this was similar to what James Hartley from Verus Financial mentioned in his presentation at the last Task Force meeting about insurance audits. They are not relevant to the State of Delaware because it is all addressed property, but there was a long period of time when there were amounts that should have been tendered as unclaimed property. Once that area has been cleaned up, the industry will get into a rhythm of returning property and there will be less revenue for the State. It seems as though there is something new every 3 – 4 years in equities; it is a cycle. The State has done some positive things in the way they have reformed the disposition of shares.

Deputy Secretary Gregor said regarding the \$58 million in shares, the State did not liquidate it so it was never declared as revenue. This was a customer service that does not count as revenue.

Mr. Togman asked what happens to the dividends on those shares while the State is holding them.

Deputy Secretary Gregor said if the owner asks for the dividends the State returns them.

Senator Townsend asked what happens if the owner does not ask for the dividends.

Deputy Secretary Gregor said in that case the State keeps them. If there is no claim made for the assets they are not returned.

Senator Townsend said if there is a claim made for the shares and not the dividends that could indicate that there is an address for those dividends as well.

Deputy Secretary Gregor said there used to be some system limitations that prevented that connection from being made, but it is something that DOF would be willing to work on if the Task Force makes that recommendation.

Senator Townsend asked if there was any sense of what the value of those dividends would be.

Deputy Secretary Gregor said he did not know.

Senator Townsend referred to DOF's figure of \$58 million in shares returned in FY 2014. He asked if that was measured by a certain date they were returned or what the market value was when they were escheated.

Deputy Secretary Gregor said that the figure was based on the value of the shares either on the day the State received them or on the value the day they were returned.

Mr. Rosen said it might not matter which day was used because it was not being counted as revenue. If dividends were approximately 2% of the shares and the total was \$58 million, then the dividends could be worth \$1 million.

Mr. Collins asked if the owners had to make a claim expressly for the dividends or if they were included with the shares.

Deputy Secretary Gregor said that it has been a case-by-case situation. There have been system limitations but they are updating to a new system, which should make connecting owners of shares with the dividends easier.

Mr. Togman asked what the length of time that the State keeps shares while doing due diligence is before the shares are liquidated.

Deputy Secretary Gregor said that it is 60 – 90 days from the time that the owner should have received the due diligence letters. If the last known address is in Delaware, DOF holds onto the shares for a longer period of time before liquidating them.

Senator Lavelle asked if there is a dividend with a share if the State keeps it. Is the State aware that the dividend for the share exists?

Secretary Cook said yes.

Senator Lavelle said that does not seem fair. If the premise of this program is to return money that does not belong to the State, then not sending the dividend with the share to the owner does not fulfill that premise.

Senator Townsend said it seems like there were some systemic limitations that prevented DOF from returning the dividends with the shares. It is good to know that they now support an automated service to return the shares and the dividends together to the owner.

Secretary Cook returned to his presentation. He explained what the State is looking for when it hires contract auditors. One of the main things that holders are concerned about is confidentiality. They want to make sure that when they interact with auditors that all information will be kept in confidence. The holders look for predictability and properly documented and clear findings. It is important that auditors have in-house expertise and capacity, such as a good IT infrastructure. They must also have legal support and a detailed statistical sampling method.

Mr. Houghton asked why contract auditors would need to have legal support since the State already has attorneys to advise them. He is not sure why that would be a predicate to hiring an auditing company, because they would be dealing with Delaware law which State attorneys could advise on.

Secretary Cook said that he thinks that contract auditors do need that experience because they work in multiple states. The DOJ gets involved in different kinds of dispute. Companies like Kelmar need to have a background in Delaware law if they are going to be working in Delaware.

Mr. Houghton asked if Secretary Cook meant that an auditing company would have to understand the rules of Delaware, including that they would not be allowed any substantive decision-making power during the audit.

Secretary Cook said that is what he meant, and that in the last meeting Kelmar and the State had made it clear that the auditing companies do not have decision-making power in the audit. The State makes all final decisions.

Secretary Bullock said that there are many issues that are a matter of interpretation in an audit. If the State had to ask the Attorney General's Office for every one of those issues, they would have to have three or four more Deputy Attorney Generals (DAGs).

Mr. Houghton said that there probably should be more DAGs assigned to an area that is a \$600 million revenue source.

Secretary Bullock said perhaps that is true, but it would cost a lot of money. There are parts of the audit that require negotiating, and lawyers tend to be good at that.

Mr. Rosen asked if the State has a contract auditor "best practices" manual that includes the selection process of contract auditors, criteria that auditors must meet, and the steps of the audit process.

Secretary Cook said that a lot of that information was already laid out in the contracts the State has with contract auditors.

Mr. Rosen said he has seen the contracts and contracts are negotiated.

Deputy Secretary Gregor said that they are often boilerplate contracts.

Mr. Rosen said that the two contracts he looked at were boilerplate contracts, but that parts of them were negotiated. He asked if there is a manual that lists the standards the auditors must meet in order to be considered as a contract auditor for the State.

Deputy Secretary Gregor said that he has been the State Escheator for a little over a year. When he became State Escheator there were already many contract auditors working for the State. One of the first things he did was make a list of best practices, business philosophies, and expertise. All contract auditors were brought in to make a presentation and to discuss every item. It was made clear that any contract auditor that wanted to continue working for the State had to meet those standards. This list was never published, but it let auditors know what the State expected from them in terms of professional conduct and work product.

Mr. Rosen said that he thinks a best practices guide for auditors and the audit process would go a long way to show fairness.

Secretary Cook said that other states have done something similar to that and that holders have found that helpful. He said that one of the outcomes of this Task Force could be to publish a best practices manual.

Mr. Stevenson said that he is concerned that Kelmar is getting the majority of the auditing cases. He guessed that Kelmar is also being assigned the most lucrative audits as well. Mr. Stevenson asked if there was anything in this field that is precluding competition from other auditing firms.

Secretary Cook said that the chart on the "Diversifying Enforcement Support" slide showed how many cases were assigned in the past two fiscal years to each of the five auditing firms the State contracts with, for a total of 45 cases. They have been focusing on auditing the companies that did not sign up for the VDA program.

Ms. Whitaker said that they are focusing on companies (not all large companies) that are not a part of the VDA program. There is a wide range of company sizes.

Representative Bryon Short asked Ms. Whitaker to be more specific about the types of companies she was talking about.

Ms. Whitaker said that the companies are not “mom and pop shops,” but that they are not all Fortune 100 companies either. They all are valued at over \$1 million.

Secretary Cook said that the chart also listed the number of employees each contract auditor employs. Kelmar has 147 employees that do audits and also have approximately another fifty employees who are support staff.

Senator Townsend asked if this was the number of employees who work on Delaware audits or the total number that work at the auditing firms.

Secretary Cook said that it was the total number of employees at the firms.

Senator Townsend said that puts why the State gives so many more audits to Kelmar in context- they have more employees and can handle the higher caseload.

Mr. Stevenson said that he does not think this slide is representative of the last eight years. It has been a very lucrative business for Kelmar. Normally in this instance you would see real competition from other auditing firms.

Deputy Secretary Gregor said that Xerox is an audit firm that specialized in equity audits. They used to have a very significant audit presence and they are in the process of rebuilding that. Kelmar is the gold standard in the audit field. Xerox has lost employees to Kelmar. The State would like there to be more competition in the field, but the State only hires contract auditors that only represent states, rather than those who represent both states and holders.

Senator Lavelle said that Kelmar received about \$50 million dollars in their contract. He asked which auditing firm earned the next-highest paycheck.

Deputy Secretary Gregor said that year it would probably have been Specialty Audit Services (SAS) and they would have received a paycheck in the single digit millions.

Secretary Cook said that year was also the year of the transfer agency project. Kelmar brought in over \$400 million in revenue.

Mr. Houghton said that there have not been a huge number of new audits started by the State of Delaware in the past year. He asked what the total number of audits in their entirety assigned to Kelmar. Statistically, audits can last anywhere from three to eight years, sometimes longer. What is the total number that each of the firms listed has in the queue? It seems as though FY 2013 and FY 2014 were relatively slow years in terms of auditing, yet Innovative Advocates did not exist 18 months ago.

Deputy Secretary Gregor said that Kelmar has approximately 300 cases at the moment and there are a total of approximately 375 audits being conducted.

Mr. Ratledge said that after speaking with Kelmar auditors, he wonders how anyone could do this job with the subsidiaries that are involved with some of the large companies without having a large and experienced staff. It is very clear that this area requires a lot of experience and expertise; it is not easy.

Senator Townsend said that he is aware of the irony of some of the comments that have said the large size of Kelmar is a bad thing, whereas normally growth and success would be looked at as a good thing.

Mr. Tuinstra, Jr. confirmed that there are 375 open audits that the State is conducting and that 300 of them have been assigned to Kelmar.

Secretary Cook said that is correct.

Senator Lavelle said that it is important to grow the audit service industry in order to drive down prices so that the State could save money and not be so reliant on certain audit firms.

Mr. Houghton said that he thought that he heard someone say that these auditing companies do not want to grow. He said that is not the case. Companies would grow if they knew there would be a guaranteed stream of work that would support their infrastructure. It is like any business: they grow proportionally to the amount of work they have or foresee having in the future.

Deputy Secretary Gregor said that what the State has tried to do in the past couple of years is gauge the amount of work companies can handle right away. The State would like to give the smaller auditing firms more cases, but the State also has to be sure that it is getting the kind of work product it wants. Small businesses sometimes have growing pains as they are starting out. The State does not want the smaller firms to be overwhelmed, but they are parsing out cases differently than in previous years. Kelmar has three-quarters of the cases, but in the past couple of years has only received half the cases. The State is making efforts to spread the work out more.

Mr. Houghton said that Kelmar in the past five years has expanded from representing 12 – 15 states to representing over thirty. They are providing audit services and a significant amount of IT support. They are modifying their model because Kelmar is anticipating that the workload from Delaware is going to decline. If Delaware is going to maintain a credible audit business it will have to diversify the number of audits it gives to others.

Mr. Ratledge said that part of the purpose of his visit with Kelmar employees was to determine if they are applying estimation and extrapolation arbitrarily. They have to ground their decisions in policy or law. Kelmar had the right answers, but that does not mean that other firms would not also have the right answers.

Secretary Bullock said that he interprets this chart in the same way he interpreted DOF's modifications to their due diligence practices: it is a change that is a reaction to criticism of DOF. DOF was told that too much work was being assigned to Kelmar and that the workload should be more spread out. As a result, DOF is trying to take a more balanced approach to assigning cases. If there is less of a reliance on audits, a lot of the problems being discussed (like estimation) would go away. He thinks that is what has been happening over the past 18 months.

Secretary Cook said that DOF is encouraging companies to join Secretary Bullock's VDA program. This makes annual filings and revenue more predictable.

Deputy Secretary Gregor said that there are more than twice as many companies in the VDA program as there are under audit.

Mr. Rosen said that he agreed with Secretary Bullock. It is better to have voluntary compliance than to have to rely on audits. He asked why the State has not considered adding, on a gradual basis, a qualified audit unit within the State. The State could be its own vendor.

Secretary Cook said that is something that has been discussed. The auditing companies are auditing large multinational corporations with many subsidiaries. The State does not have the expertise or resources to do those audits. The State has hired auditors in the past and they have left because they can get a higher salary in the private sector. DOF has discussed hiring auditors to perform some of the smaller in-state audits.

Mr. Rosen said he did not think that the State was going to compete with Kelmar for the reasons that Secretary Cook mentioned. If the State added on a small number of employees on a gradual basis to do some of the smaller audits then the State could save money.

Mr. Houghton said that there is precedence for this. When the Division of Revenue ran the VDA program it was staffed internally and it was successful. There is the historical capacity within the Division of Revenue to do reviews. There is no reason that capacity could not be expanded internally and applied to some extent to audits.

Senator Townsend said that he has been surprised to hear that State employees are burdens on the system and that they do not provide a benefit because he does not agree with that. He asked to hear some detailed descriptions of the types of tasks that could be assigned to in-house workers.

Mr. Ratledge asked what would be the change in revenue as a result of this. For example, the VDA program has been put into effect; what has been the net change as a result of that? Secretary Bullock had mentioned earlier that approximately 33% of companies that could have joined the VDA did. Mr. Ratledge questioned whether those companies would have joined if there was no threat of auditing. Mr. Ratledge does not believe that unclaimed property would decrease as a result of the VDA program. Technology has been around for decades and unclaimed property is still increasing.

Mr. Tuinstra, Jr. said that it is important to have a good audit program. He does not think that anyone in the business community is advocating that audits should be eliminated. A strong audit program also should have strong rules so that the methodology and rules are very clear.

Senator Townsend asked what types of tasks could be assigned to in-house workers.

Secretary Cook said that the VDA program recently ended and that the increase from that program is over.

Senator Townsend asked about the final results of the VDA program.

Secretary Cook said the legislation allowed companies to sign up for Secretary Bullock's VDA program. If companies signed up within the first year the look-back period was limited to 1996 instead of 1991. If they signed up by September 30, 2014 the look-back period was limited to 1993. Because that date has passed, no other companies can sign up for the VDA program. The look-back reverts back to DOF's 1991 look-back. On the audit side, the regulations changed the look-back period to 1986. It will stay at 1986 until June 30, 2015 when it will revert back to 1981.

Senator Townsend asked if there was an increase in enrollees and what the differences between the DOS and DOF VDA programs are.

Secretary Bullock said yes. In the past couple of days approximately 75 companies signed up. Companies cannot sign up for his VDA program any longer.

Ms. Whitaker said that the look-back period is different, with DOF's being 1991. She did not think the methodology of the two programs is significantly different. DOF's program is still accepting enrollees.

Mr. Togman asked for clarification of the look-back periods for each VDA program.

Ms. Whitaker said the Secretary of State's VDA program had a look-back to 1993 and the Secretary of Finance's program had a look-back to 1991. There was some confusion in the industry about the two programs, so DOF changed their look-back period to 1993 to mirror the DOS VDA program.

Deputy Secretary Gregor said that there has been a perpetual amnesty program. This will always be open. Auditing companies that are noncompliant is important.

Senator Townsend said it has been established in previous meetings that no one has a problem with auditing companies that are deliberately in noncompliance.

Senator Lavelle said that he would not agree that the methodology of the DOS and DOF programs is the same.

Ms. Whitaker said that they are not identical, but that she would not consider them to be significantly different.

Senator Lavelle said that he realizes that there are differences in the look-back periods. Putting that aside, if he was a sneaky, mean company he could just sign up for the VDA and then not comply with the State.

Secretary Bullock said that it is a voluntary program. That works both ways. Companies that do not comply get kicked out. DOS also had a reputational advantage with this program; it has a good relationship with holders. DOS was also successful in marketing the program.

Senator Lavelle asked if the arrangements that DOS has with outside vendors is different than the ones DOF has with contract auditors.

Secretary Bullock said that it is, but the vendors are paid an hourly rate not a percentage.

Senator Townsend asked what the timeframe was for any type of analysis or report on the DOS VDA program. He asked what implications would there be on the audit system now that the DOS VDA program is closed.

Secretary Bullock said he thinks that there will have to be some kind of successor to the DOS VDA program, although he is not sure what that would be. They have done all that can be done with the VDA program, so it would have to be a variation on that.

Senator Townsend asked if the DOF VDA program would serve as a long-term successor.

Secretary Bullock said that it has historically been the alternative to an audit, but it is hard to tell what will happen in the future.

Senator Townsend said he would be interested in seeing some analysis of the implications of this program ending and the audit and DOF VDA programs being in the same department. He again expressed his interest in hearing some detailed descriptions of the types of tasks that could be assigned to in-house State workers.

Secretary Cook said that he thought that in-house State workers could be hired to work in a limited scope. The biggest fear is that the State will invest time and money in training employees and have them leave to work in the private industry. The opportune time to do this may be during the transition period between the DOS and DOF VDA programs.

Senator Townsend asked if there were any specific tasks that could be assigned to State workers.

Deputy Secretary Gregor answered that those employees could work on the VDA. They would be reviewing the methodology that has already been put forth, rather than gathering the data in an audit.

Senator Townsend asked if the idea of using in-house workers was ever considered for the DOS VDA program.

Secretary Bullock said no, because the ramp-up for the VDA program had to be so fast. The DOS VDA program was a limited time program. There was not enough time to do the kind of staffing Senator Townsend described. If the DOS VDA had been a longer program, Secretary Bullock would have probably hired more staff. The task would have required highly skilled employees, which would have probably been expensive.

Senator Townsend said that he realized that as a result of companies joining the DOS VDA that there are a lot of audits in the pipeline. He asked if more in-house State staff could be hired to help with that backlog.

Secretary Bullock said that they would only be able to be hired for a limited duration, since his program ends on June 30, 2016. Staff would only be hired for approximately twenty months.

Senator Townsend said that just because that particular program will end does not mean that the staff could not be reassigned to work on other projects. The expertise and skills developed during that time could be transferred to other tasks. This could save the taxpayers money.

Representative Jeff Spiegelman referenced Secretary Bullock's earlier statement that 75 companies had joined his VDA program in the last couple of days. He asked if he thought that was just a last-minute rush.

Secretary Bullock said that he thought it might be.

Representative Spiegelman asked if the DOS VDA program was extended if more companies would join.

Secretary Bullock said that because of the marketing that was done for this program, companies all knew about the VDA program. They chose not to join. He does not think more companies would join if the program was extended; there has to be something that is a little different.

Mr. Houghton said that several large companies contacted him in the past couple of days who were considering joining the VDA program. After looking at the cost, time, and effort it would take to join the program, they decided that it was not worth it. One of the problems that companies had with the Division of Revenue VDA was that there was an 18 month post-closure audit period. VDAs could be closed, but the State then had 18 months to audit the company for the same period. Mr. Houghton said he represented at least two companies that had that experience.

Mr. Stevenson said that the fact that the audit was a possibility was a reason why companies preferred the DOS's VDA program.

Mr. Houghton said that he is not sure that the Task Force will have sufficient time to develop a set of comprehensive recommendations.

Mr. Togman noted that if the Task Force does not make any changes that could impact Delaware's fiscal future. It could cause corporations to incorporate elsewhere.

Mr. Tuinstra, Jr. said that a representative from the Council on State Taxation (COST) was present at the meeting and could offer insight into that issue from the perspective of holders. Secondly, he requested that the Task Force members receive some guidance as to how to proceed with their recommendations.

Secretary Cook returned to the presentation. He said that there are several important things to note about the contracts the State has with auditors. The State, not the auditing firms, makes all critical decisions related to the audit. Delaware is not the exception; all states use contractors. The reason why DOF has such lengthy contracts with auditors is because unclaimed property exams typically take years. Having a shorter contract would mean renegotiating with the contract auditor when examinations are only partially complete. Having a longer contract also locks in costs, but it does not lock in operations. The State has the prerogative to stop assigning cases or to reassign cases at any time.

Senator Lavelle referred to Kelmar receiving \$50 million last year. He asked how many hours they worked.

Secretary Cook said he could get that information for the next meeting.

Senator Lavelle asked what the highest payment was to a VDA member in 2013.

Secretary Bullock said that he did not have that information on hand, but he believed that the point Senator Lavelle was trying to make was that the cost of a VDA is less than that of an audit. That is true.

Senator Lavelle expressed concern that because the contracts are so long that qualified auditors would be precluded from being an auditor for the State.

Secretary Cook said that is not the case because DOF has a rolling RFP. The State can bring on new auditors at any time, not just every so often as would be the case with the normal RFP process.

Senator Townsend asked what the lengths of the contracts were for other smaller auditing firms.

Ms. Whitaker said that Innovative Advocates' contract mirrors the length of Kelmar's. Specialty Audit Services (SAS) has continually requested two-year contracts and DOF continues to honor that request.

Senator Townsend said that the contract formalizes the relationship between the auditing company and the State; it does not guarantee what they get paid.

Ferdinand Hogroian, Tax & Legislative Counsel at COST, said that COST conducted a survey of its members as a reaction to some of the concerns expressed at the previous Task Force meeting. They wanted to substantiate some of the concerns that holders have. COST conducted an anonymous survey via Survey Monkey of the COST Unclaimed Property Committee (consisting of about forty members, some not Delaware-incorporated and not participating in the survey). This survey showed that members have a robust multistate filing history as well as a robust Delaware filing history. There is a comments section where members could expand on their concerns. The holders expressed concerns about estimation and the record retention period. Companies that responded also stated that they have had to pay over \$1 million in legal fees and staffing costs as a result of the audit, and that does not include the amount that the audit finds them liable for. Mr. Hogroian said that the reason why companies preferred the DOS VDA to the DOF VDA was because they knew they would not get audited after joining and there was clarity about the process.

Senator Townsend said that if that was true, why didn't more companies sign up?

Mr. Hogroian said that a lot of the member companies of COST are ineligible to sign up for the VDA program.

Secretary Cook asked how many members are in COST.

Mr. Hogroian said that there are over 600.

Secretary Cook asked why there were only responses from 14 companies.

Mr. Hogroian said that they sent the survey out only to the members of the COST Unclaimed Property Committee. They did not want to spread the link to the survey around too widely because anyone could answer the survey questions. Mr. Hogroian urged the Task Force members to review the comments section, because those are unfiltered opinions from member companies.

It would be very difficult for those people to represent their companies and express those opinions openly in person to the Task Force.

Senator Townsend thanked Mr. Hogroian. He referred to Mr. Tuinstra, Jr.'s earlier comment about the process of making recommendations. Senator Townsend noted that there is a decent amount of consensus between Task Force members on several topics, particularly in the consumer protection aspect. He noted the irony that the length of record retention is exceeded by that the dormancy period plus the statute of limitations. Companies are being authorized to shred records but the statute of limitations is still open. He would advocate shortening the statute of limitations so that it, plus the dormancy period, equals the length of record retention requirements.

Mr. Togman said another item that could be reviewed is the fairness of the appeal process.

Senator Townsend agreed that is something that could be discussed. He remembered someone at an earlier meeting stating that there could be a mutual selection of an arbitrator.

Mr. Tuinstra, Jr. said that another aspect of that topic that should be discussed is that the Secretary of Finance can reject or modify the decision of the arbitrator. This process does not look fair to an outsider. There is no appearance of fairness.

Mr. Houghton said that has been the fundamental criticism of the process. The appeals process is potentially very lengthy process. He thinks that the appeals process can be tightened up. The appeals process has not been used very much, but that could be because it is viewed as cumbersome and unfair.

Mr. Tuinstra, Jr. said that this process is not a normal administrative appeals process in terms of that step.

Michael Barlow, Chief of Staff in the Office of the Governor, said that he disagrees with Mr. Tuinstra, Jr.'s comment. It is actually standard practice in other administrative procedures to appoint a hearing officer who makes a recommendation to a Cabinet Secretary. It is done this way because the concept of fact-gathering involves very intensive efforts. It can be questioned whether or not this process makes the most sense, but the fact is that there is a Chancery process that provides for the court to make a ruling. What Delaware does not have, by tradition, that some other states have is a robust administrative law judge. This independent hearing officer process is more common.

Mr. Tuinstra, Jr. clarified his earlier statement to say that it is not a common practice in the tax world.

Mr. Rosen said that he would recommend that the Task Force make a recommendation about what the definition of abandoned property is and what property is subject to escheat. He also recommends that a best practices manual be published to promote the idea of fairness and transparency. In the tax profession, a lot of attention nationwide is being paid to how Delaware handles the unclaimed property issue.

Senator Townsend said that he is happy to further discuss the idea of a more concrete definition of unclaimed property but he is not sure that it will solve any problems in the business community.

Mr. Rosen said that he does not think that the Task Force can come up with a comprehensive list to solve all of the problems discussed. The General Assembly will have to be involved in legislating. There does need to be a framework in place for a starting point.

Mr. Togman said that he would like to know how much of the revenue from abandoned property is attributable to business-to-business transactions and gift cards. He would also like to consider what including those items as abandoned property does to Delaware's reputation. COST rates Delaware as a D- as compared to other states. There should be a discussion on whether or not including those items should be changed.

Mr. Rosen asked if there was a possibility that the Task Force report deadline could be extended to allow for additional meetings.

Senator Townsend said that legally, no. Practically, conversations could continue. It will have to depend on how members feel about the final report.

Secretary Cook asked if DOF will have an opportunity at the next meeting to present some of the data that was requested at this meeting.

Senator Townsend said yes.

Mr. Houghton said that a limitation on the look-back be something that is considered.

Senator Townsend said that he does think it is ironic that companies are required to produce records for the past thirty years during an audit when the State of Delaware would not be able to produce their records from that long ago. However, most of the companies who are complaining about the look-back period are companies that are not in compliance at all. DOF is targeting large (\$1 million+) companies who do not have a history of filing, and the Task Force has agreed that companies who are not in compliance should be audited.

Mr. Tuinstra, Jr. said that his response to Senator Townsend's statement would be that all of the comments from the COST survey were from companies who had filed and were still being subject to audits.

Senator Townsend said that it is very difficult to make major modifications to state law based on anonymous comments. There is nothing unfair or aggressive about that.

Secretary Cook said that he thought that COST would have brought in a member company that had completed the audit process and that was indemnified to talk about their experiences. DOF has responded to criticisms to try to make the process fair and equitable and that they will continue to make changes.

Senator Townsend said that he does not know that any legislator on the Task Force that has been contacted by specific companies about their experiences. He has heard from companies in reference to other aspects of Delaware law.

Senator Lavelle said that he actually was contacted by a company. He said that the company felt that the audit process was heavy-handed and unreasonable. They were so unhappy that they were considering shrinking their business in Delaware.

Representative Short asked if the company that Senator Lavelle was referring to was on compliance.

Senator Lavelle said he did not know.

Mr. Stevenson said that in terms of compliance versus noncompliance, there are companies that have no contact with the State of Delaware other than the fact that they are incorporated there. They may not have been under obligation to file because they might not have any Delaware employees or vendors. If there is an audit there is no record that they have filed, but they have never been required to file. The State might say that they are noncompliant, but really the companies are unable to defend themselves because they have never filed. Mr. Stevenson said that he does not agree with the premise of estimation when non-Delaware items are included (total unclaimed property is estimated). He does not think that there is any specific instance that makes the process unfair; the premise the audit is based on is unfair. Mr. Stevenson would not think the company is noncompliant in this scenario.

Mr. Rosen said that there need to be clear rules about the statute of limitation policies and record retention policies.

Mr. Tuinstra, Jr. said that Kelmar is auditing non-filers. They go back to 1986 to check if a company underfiles. That is part of the problem because a company may think that they have kept the appropriate records for the statute of limitations and then are not able to prove that they have not underfiled. He did not think that all of the audits Kelmar does are targeting non-filers.

Secretary Cook said probably not all of the 300 cases that Kelmar has been assigned are non-filing companies. However, in the past two years what DOF has tried to do is to focus mainly on non-filers.

Mr. Tuinstra, Jr. said that companies could have filed, but the look-back is still to 1986 to see whether the company filed appropriately.

Deputy Secretary Gregor said that if a major Fortune 100 company only files every fifth year and only files insignificant amounts that would be something that the audit would investigate further. The company has filed in the past, but their filing history indicates that they may be underfiling.

Mr. Tuinstra, Jr. said that his point regardless of whether or not the company filed correctly, there is a statute of limitations that should be adhered to.

Senator Townsend said that Mr. Tuinstra, Jr.'s comment related to his suggestion earlier that the two time periods should match. Even if the time periods match there are still going to be situations where the look-back period is implicated. It is not fair to characterize the situation as a filer going through the pain of an audit. The filer is going through the pain of an audit because there is substantial evidence to support that they have dramatically underfiled in the past. It's a whole separate basis for characterization and sympathy. Senator Townsend said there is a lack of

evidence to support that the people who are being targeted by audits are those who consistently file the correct amounts.

Mr. Houghton said that he would recommend that Task Force members think of the situation with a more pragmatic approach. The Task Force could stay the course, but he thinks the State will see more and more litigation.

Secretary Bullock said that DOF has made great improvements over the past couple of years. He does not think State courts would change the process. The Task Force is charged with identifying more areas of improvement. He said that the Task Force should wait to see the report and see if it reflects the ideas and tone of the previous discussions. It is unfair to suggest that there have not been changes to statutes made to reflect the changing world and the value of this source of revenue.

Mr. Collins said that there are changes and improvements being made, but this field is being used as a revenue source but it really is not the State's money. Whether or not collections will continue remains to be seen. Regardless of what is decided, whatever the State does needs to be predictable to the business community in order to retain corporate benefits. There should not be too dramatic of a deviation, it should be straightforward.

## **PUBLIC COMMENT**

There was no comment from the public.

Senator Townsend thanked the task force members for attending and for their comments. The next Task Force meeting will be held on Tuesday, October 28, 2014 from 10:00 a.m. – 12:00 p.m. in the Senate Hearing Room at Legislative Hall in Dover.

The meeting was adjourned at 4:04 p.m.